IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1979

No. 79-1515

UNITED STATES OF AMERICA,
Petitioner,
v.
ELWOOD SWANK AND RITA SWANK

UNITED STATES OF AMERICA,
Petitioner,
v.
BLACK HAWK COAL CORPORATION, INC.

UNITED STATES OF AMERICA,
Petitioner,
v.
BULL RUN MINING CO., INC.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF IN OPPOSITION

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BRIEF IN OPPOSITION

OPINION BELOW

The opinion of the Court of Claims is reported at 602 F.2d 348, and is correctly reproduced in Appendix A, pages 1a-10a, of the Petition for a Writ of Certiorari. The opinion of the trial judge (*id.*, pages 10a-16a) and his

findings of fact, which are not printed with the court's opinion, apply only to Elwood Swank and Rita Swank (No. 403-75) (*id.*, page 9a). The Court of Claims adopted the parties' stipulation of facts as the court's findings of fact in Black Hawk Coal Corporation, Inc. (No. 49-77) (*id.*, page 4a, n. 2). In Bull Run Mining Co., Inc. (No. 400-77) the court found that the relevant facts were not in dispute and stated that its opinion reflected such facts as were necessary to sustain its disposition of the cross-motions for summary judgment (*ibid.*).

JURISDICTION

Respondents accept the statement of jurisdiction offered by Petitioner.

QUESTION PRESENTED

Whether the inclusion of a 30-day termination clause in a coal lease precludes the lessee's entitlement to the percentage depletion deduction prescribed by Section 611(a) and (b) of the Internal Revenue Code of 1954. (Black Hawk Coal Corporation case (No. 49-77), Stipulation of Facts, ¶ 15.) The Government admits that in the absence of this 30-day termination provision, the lessees would all be entitled to such depletion allowance.

STATUTES AND REGULATIONS INVOLVED

Petitioner cites and sets forth in Appendix C certain portions of Sections 611 and 613 of the Internal Revenue Code of 1954 (26 U.S.C.), and of Treasury Regulations on Income Tax, Section 1.611-1 (26 C.F.R.) (Petition for a Writ of Certiorari, pages 2, 23a-25a). Respondents agree that these provisions are involved.

In addition to the above provisions, Respondents respectfully invite the attention of the Court to the fol-

lowing pertinent provisions of the Internal Revenue Code of 1954 and Treasury Regulations issued thereunder:

Internal Revenue Code of 1954

Section 272. Disposal of Coal or Domestic Iron Ore.

Where the disposal of coal or iron ore is covered by section 631, no deduction shall be allowed for expenditures attributable to the making and administering of the contract under which such disposition occurs and to the preservation of the economic interest retained under such contract, except that if in any taxable year such expenditures plus the adjusted depletion basis of the coal or iron ore disposed of in such taxable year exceed the amount realized under such contract, such excess, to the extent not availed of as a reduction of gain under section 1231, shall be a loss deductible under section 165(a). This section shall not apply to any taxable year during which there is no income under the contract.

Section 611(b)(1). Allowance of Deduction for Depletion.

Special Rules – Leases.

(b) Special Rules. –

(1) Leases. – In the case of a lease, the deduction under this section shall be equitably apportioned between the lessor and lessee.

Section 612. Basis for Cost Depletion.

Except as otherwise provided in this subchapter, the basis on which depletion is to be allowed in respect of any property shall be the adjusted basis provided in section 1011 for the purpose of determining the gain upon the sale or other disposition of such property.

Section 613(b)(4). Percentage Depletion Rates – Coal, etc.

(b) *Percentage Depletion Rates.* – The mines, wells, and other natural deposits, and the percentages, referred to in subsection (a) are as follows:

* * * * *

(4) *10 Percent-Asbestos* (if paragraph (1)(B) does not apply), brucite, coal, lignite, perlite, sodium chloride, and wollastonite.

Section 613(c). Percentage Depletion. Definition of Gross Income from Property.

(For text, see Appendix A, *infra,* page 1a.)

Section 631(c). Disposal of Coal or Domestic Iron Ore With a Retained Economic Interest.

(For text, see Appendix A, page 2a.)

Treasury Regulations

Section 1.272-1. Expenditures relating to disposal of coal or domestic iron ore.

(For text, see Appendix A, page 3a.)

Section 1.611-1. Allowance of deduction for depletion.

(b) *Economic interest.*

* * * * *

(2) No depletion deduction shall be allowed the owner with respect to any timber, coal or domestic iron ore that such owner has disposed of under any form of contract by virtue of which he retains an economic inter-

est in such timber, coal, or iron ore, if such disposal is considered a sale of timber, coal, or domestic iron ore under section 631(b) or (c).

(c) *Special rules* –

* * * * *

(2) *Leases.* In the case of a lease, the deduction for depletion under section 611 shall be equitably apportioned between the lessor and lessee. In the case of a lease or other contract providing for the sharing of economic interest in a mineral deposit or standing timber, such deduction shall be computed by each taxpayer by reference to the adjusted basis of his property determined in accordance with sections 611 and 612, or computed in accordance with section 613, if applicable, and the regulations thereunder.

Section 1.612-1. Basis for allowance of cost depletion.

(For text, see Appendix A, page 7a.)

Section 1.613.1. Percentage depletion; general rule.

(For text, see Appendix A, page 8a.)

Section 1.631-3. Gain or loss upon the disposal of coal or domestic iron ore with a retained economic interest.

(For text, see Appendix A, page 9a.)

STATEMENT OF THE CASE

a. *Swank.* The termination clauses in the leases involved in this case were never exercised.

Pursuant to a deep mining lease dated October 24, 1964, Swank[1] as lessee deep mined anthracite coal from

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[1] References to Swank are to Respondent Elwood Swank. Rita Swank is a party solely because she filed joint federal income tax returns with her husband during the years in suit.

1964 through 1967. Pursuant to a stripping lease dated July 25, 1966, Swank as lessee strip mined anthracite coal during 1966 and 1967. The lessor under these mining leases was Northumberland County. The lessor never terminated the leases. Swank's successor, Split Vein Coal Company, Inc.,[2] is still mining pursuant to the stripping lease. The 1964 deep mining lease was abandoned in May 1968 because of a mountain slide caused by heavy rains which closed the deep mine, thereby preventing further mining of the mine by anyone. Swank and his successor, Split Vein Coal Company, Inc., deep mined coal under the deep mining lease until the mountain slide closed the mine. (Findings Nos. 6-9.)

Swank did not negotiate or prepare the leases. He could not do so. These leases were on standard forms prepared and used by the County of Northumberland. The leases were not subject to negotiation. Northumberland County never sold a fee simple interest in coal lands for fear of criticism over selling such land if valuable minerals were discovered subsequent to sale. The Northumberland County Commissioners told Swank that Northumberland County would not terminate his leases except for cause. The commissioners also announced this policy not to terminate mining leases except for cause in public meetings and in the press. Every lessee of county coal lands received the same form lease from the county and in each case it was with the stipulation that the county would not terminate except for cause. The

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[2]During 1966 and the first four months of 1967, Swank was a sole proprietorship. On May 1, 1967, the assets of the sole proprietorship were transferred to Split Vein Coal Company, Inc., in a tax-free incorporation pursuant to Section 351 of the Internal Revenue Code of 1954, as amended.

reason for this policy was that the county commissioners recognized that they could not expect a lessee of county coal lands, like Swank, to invest time and considerable capital in the development of county coal lands without some assurance that, if he conformed to the terms of the lease, he would be allowed to recover his investment and make a profit on his mine. (Findings Nos. 12, 12n.1, 15(a), 15(c).)

The Northumberland County Commissioners terminated mining leases only for cause, which meant:

(1) Failure to pay the royalties; or

(2) Failure to pay the correct amount of royalties; or

(3) Failure to make the mine productive. (Finding No. 15(a).)

The *Swank* leases contain no express language permitting Northumberland County to terminate the leases "without cause." The words "without cause" are not in in the leases. (Partial Stip. Exs. A, B, C.)

Swank was under no obligation to sell the coal to Northumberland County or any other party or person. He sold the coal to whomever he pleased at whatever price he could obtain. Swank sold no coal to Northumberland County.

The income which Swank received from his mining operations was solely derived from, and tied to, his extraction and sale of coal during the tax years involved. Swank looked solely to the extraction of coal for a return of his investment. (Findings Nos. 7, 10, 11, 14, 15.) Swank was not a mining contractor. He was mining coal as a lessee under valid coal leases. (Findings Nos. 6, 17.)

b. *Black Hawk Coal Corporation, Inc.* Respondents accept Petitioner's Statement with respect to Black Hawk (Petition for a Writ of Certiorari, pages 4-5) with the following exceptions and additions:

The termination clause in the lease was never exercised (Stipulation of Facts, ¶ ¶ 2, 3, 4, 5, and 7).

The Agreement of Lease at issue (Ex. 4 to Stipulation, ¶ 3) contains no provision that the lease may be cancelled "without cause." The provision relating to cancellation of the lease by either party is contained in paragraph 15th of the lease, and provides in full as follows:

> 15th. This agreement of lease may be cancelled by either party hereto at any time by either party giving to the other thirty (30) days written notice of its or his intention to cancel same. Said notices shall be sufficient if given by registered letter postmarked in the United States mails, and thirty (30) days after receipt of said letter said agreement of lease shall stand cancelled and terminated, and shall be of no further force and effect.

The fourth paragraph of page 3 of the lease provides as follows:

> TO HAVE AND TO HOLD the hereinbefore described rights and privileges, excepting and reserving as aforesaid, unto the said LESSEE, during the term commencing on the first day of March, 1964, and terminating when the LESSEE shall have exhausted all of the Feds Creek (or Clintwood) Seam of coal, subject to the exceptions herein set out, or until said tenancy shall be earlier terminated as hereinafter provided.

The lessee was required to pay minimum royalties (called "rental") of $5,000 per year in advance each month,

without regard to the quantity of coal mined, and tonnage royalties of 25 cents per ton, with provisions for the recoupment of minimum royalties by crediting them toward amounts due on tonnage royalties, and carryovers of this recoupment privilege to any future month in which coal was mined (Lease, ¶¶ 1st, 2d and 3rd). The lessee was required to pay all real estate taxes, all taxes on coal mined and produced, and all taxes on lessee's plant, equipment, and improvements (Lease, ¶ 5th).

Paragraph 9th of the lease provides that the lessee "shall start operations within thirty (30) days from the date [of the lease], and shall conduct his operations in a careful and skillful manner and in accordance with any and all laws of the State of Kentucky, and of the United States of America."

Black Hawk mined coal continuously from the leased property, starting in 1964, continuing through the taxable years involved herein (1970, 1971, and 1972), and ceasing in 1976, when all the coal feasible to mine had been extracted (Stipulation of Facts, ¶¶ 2, 3, 4, 5 and 7).

The actual mining of the coal was done by independent contractors employed by Black Hawk for this purpose. Under their oral agreement with Black Hawk, the mining contractors provided the labor and supervision necessary to mine the coal and to transport the mined coal to the tipple site, for a fixed dollar amount per ton – the price per ton paid to the contractors not being dependent upon the sales price of the coal. The contractors furnished the trucks used to haul the coal from the mine site to the tipple. Black Hawk furnished the majority of the mining equipment needed by the contractors to extract the coal, constructed and maintained the ac-

cess road, and built the power lines to the mining operation. (Stipulation of Facts, ¶ 5.)

Black Hawk sold none of its coal to the lessor or the latter's sales agency. (Stipulation of Facts, ¶ 7.)

No claim for percentage depletion has been made by the lessor under the lease with Black Hawk, and no claim for percentage depletion on the coal extracted has been made by the independent mining contractors. The sole claimant to the percentage depletion deduction is Black Hawk. (Stipulation of Facts, ¶ 9.)

c. *Bull Run Mining Co., Inc.* Because Petitioner's statement of the case omits some relevant facts, Bull Run's statement necessarily will be longer than would normally be required. The following facts are drawn from the depositions taken in this matter, the exhibits filed, and the findings of the Court of Claims.

The termination clause in the lease was never exercised.

Respondent Bull Run Mining Co., Inc., was engaged in mining coal in West Virginia under a lease agreement dated June 21, 1967, between it, as lessee, and Preston County Coal and Coke Corporation, as lessor. The lease was for a five-year term and if all of the coal had not been removed at the end of the five years, Respondent had the option to renew the lease for an additional five-year term. The Respondent, at the present time, is still mining coal under a second five-year renewal of the said lease agreement. Pursuant to the terms of the lease, Respondent was authorized to extract and dispose of the coal underlying the leased premises to whomever and at what pieces it chose, without any restrictions; however, during its taxable year ended September 30, 1974, the

Respondent sold all of the coal it mined to the lessor.[3] The proceeds from the sale of the coal represent the sole source of revenue from which Respondent could recover any rents and royalties paid to the lessor for the right to mine (Bull Run Pet. ¶ ¶ 3, 5 and 7; Bull Run Pet. Ex. A).

ARGUMENT

I.

THERE IS NO CONFLICT EXCEPT WITH THE COURT OF APPEALS FOR THE THIRD CIRCUIT.

Petitioner correctly states that the instant cases are squarely in conflict with the decision of the Court of Appeals for the Third Circuit in *Whitmer v. Commissioner*, 443 F.2d 170 (1971).[4] Petitioner is in error, however, in attempting by the use of the word "similarly" (Petition for a Writ of Certiorari, page 8) to persuade this Court that there is a substantial divergence of authority elsewhere concerning the issue herein presented.

In the nine years since *Whitmer* was decided, no other Circuit Court has followed it. The decisions of the Fourth, Fifth, Sixth, Ninth and Tenth Circuits cited by

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[3]This is not a ground relied on by the Government in denying depletion.

[4]In *Costantino v. Commissioner*, 445 F.2d 405 (3d Cir. 1971), however, taxpayer was a contractor hired by the lessee, who agreed to pay her $2.60 per ton for each ton of coal mined and removed from lessee's premises and delivered to lessee's tipple. Taxpayer was not required to pay a minimum or advance royalty, and she was not required to mine the coal to exhaustion but only to excavate the coal as far as "practicable" (*id.*, at 406, 409) [Lease set out in Tax Court opinion, 29 TCM 189-90 (1970)].

Petitioner are all distinguishable, and most of them involve coal contractors rather than lessees. These cases are briefly summarized in Appendix B, pages 15a-17a.

Although the United States Tax Court, in the past, has agreed with the Court of Appeals for the Third Circuit in several cases involving thirty (30)-day and sixty (60)-day cancellation clauses, it has recently expressed considerable doubt as to the correctness of its position. In *Weaver v. Commissioner*, 72 T.C. 594 (1979),[5] the Tax Court held (in an opinion critical of *Whitmer*) that a one hundred twenty (120)-day notice period did not preclude the allowance of depletion to a lessee where the circumstances of the case indicated that such notice period "was longer than nominal and had sufficient economic significance to give the petitioner a capital interest in minerals in place" (*id.*, at 608-9). In rejecting the Commissioner's position of denying depletion on this lease, the court admitted to a desire "to avoid significantly expanding the effect of our controversial position by defining a nominal notice period more broadly than we have heretofore had to do" (*id.*, at 609).

II.

THE IMPACT ON THE REVENUE INVOLVED IN THIS ISSUE IS NEGLIGIBLE.

Admitting that it did not petition for a writ of certiorari to review the practically identical decision[6] of the Court of Claims in *Bakertown Coal Company, Inc. v. United States*, 202 Ct. Cl. 842, 485 F.2d 633 (1973) –

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[5]No appeal was filed by the Government in *Weaver*, and the appeal period has expired.

[6]Petitioner refers to "a divided en banc court" (Petition for a Writ of Certiorari, page 6). Actually, the decision was 6-1 in favor of the taxpayer-lessee.

involving the same lessor and identical leases as in the Black Hawk case – Petitioner claims that "the effect of a short notice termination clause in a mineral lease upon the lessee's entitlement to the depletion deduction has assumed greater administrative importance" since 1973 (Petition for a Writ of Certiorari, page 9).[7] Petitioner cites advice from the Internal Revenue Service that fifteen (15) cases pending administratively or in the district courts involve a total potential revenue loss of approximately $2.2 million.[8]

This figure is somewhat less than impressive, in view of total receipts from Federal income taxes of $322.9 *billion* in the fiscal year ending September 30, 1979,[9] and total estimated Federal income tax receipts of $315.7 *billion* in the fiscal year ending September 30, 1980.[10] Furthermore, if Petitioner intends to award to the lessor the depletion deduction claimed by the lessee (as suggested in the Petition for a Writ of Certiorari, page 17), it would appear that the resolution of this issue as urged by Petitioner would have no revenue effect whatsoever.

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[7]Petitioner neglects to mention *Thornberry Construction Company, Inc. v. United States*, 217 Ct.Cl. 196, 576 F.2d 346 (1978), which involved a similar issue, and in which no petition for a writ of certiorari was filed by the Government.

[8]Respondents' request to the Government for details on these cases has been answered by the filing, on April 18, 1980, of a Supplemental Memorandum stating that the total potential revenue loss is only $1,048,888.00, and that only twelve (12) cases are involved (two pending in the U.S. Court of Claims, four in the U.S. Tax Court, and six administratively). Petitioner still fails to state whether these cases involve lessees, contractors, or licensees.

[9]Source: *Annual Report of Commissioner of Internal Revenue for Fiscal Year 1979.*

[10]Source: *Fiscal Year 1981 Budget Revisions* (March 31, 1980).

Petitioner's claim that "the impact of the decision below upon the revenue can be expected to increase" because of the Service's announcement, in Rev. Rul. 77-481, 1977-2 Cum. Bull. 205, that it will not follow the *Bakertown* decision (Petition for a Writ of Certiorari, page 9), is unexplained, unsupported, and not understandable.

Since the *Bakertown* decision in 1973, most coal companies, both large and small, have been able to delete the thirty (30)-day terminability provisions in their leases, thus eliminating the question herein presented as a viable issue meeting the test of exceptional importance indicated by Rule 19(1) of the Rules of this Court.

III.

THE DECISION OF THE COURT OF CLAIMS IS IN HARMONY WITH APPLICABLE DECISIONS OF THIS COURT.

The decision of the Court of Claims in no respect conflicts with applicable decisions of this Court. The attributes of ownership of the coal in place possessed by Respondents are the same as those which this Court has repeatedly held to be the essential factors for the possession of a depletable, or "economic," interest in the mineral in place.

The final and authoritative word concerning the requisites of an "economic interest" was given by this Court in *Paragon Jewel Coal Company, Inc. v. Commissioner,* 380 U.S. 624 (1965). The issue was whether the lessee of coal lands was entitled to percentage depletion on all the gross income derived from the sale of the coal mined from its leases, or whether contract miners who did the actual mining acquired a depletable interest, within the meaning of Sections 611 and 613(b)(4) of the Internal

Revenue Code of 1954, to the extent that they were paid by the lessee for mining and delivering coal to it.

The Court held that the lessee of the coal lands was entitled to the entire percentage depletion allowance, and accordingly denied the claims of the contractors for a portion of such allowance, despite the fact that the contracts were "silent regarding termination and were apparently for an indefinite period" (*id.*, at 630). It is plain from this statement, as well as the Court's reference to the terminability factor in *Parsons v. Smith,* 359 U.S. 215 (1959) (380 U.S., at 634), that the Court did not regard the presence or absence of terminability as a determining factor in assessing, and denying, the contractors' claims to a portion of the percentage depletion allowance.

The crucial factor in the Court's denial of any depletion deduction to the contractors in *Paragon* was that they had not acquired an interest in the coal in place and had not secured income derived from the extraction of the coal to which they had to look for a return of their capital, but instead had to look solely to the personal covenant of the lessee (Paragon) for payment of the agreed upon fee regardless of the condition of the market at the time of the particular delivery of coal (380 U.S., at 635). The Court further pointed out that – unlike the owners of upland drill sites in *Commissioner v. Southwest Exploration Co.,* 350 U.S. 308 (1956), through whose land a State statute required the State's offshore oil to be extracted – the contractors were not essential parties to Paragon's lease but were wholly disassociated from it, received no fixed percentage of the net income from such lease, and looked not to the coal but to Paragon for their payment (*id.*, at 637-8).

The decision of the Court of Claims also accords with the principles of *Parsons v. Smith, supra.* There the Court denied depletion allowances to coal contractors who based their claims thereto upon an asserted legal fiction – namely, that their contractual right to mine coal from the designated lands and the use of their equipment, organizations and skills in doing so, should be regarded as the making of a capital investment in, and the acquisition of an economic interest in, the coal in place. The Court held that this asserted fiction was negated by seven facts (359 U.S., at 225). Respondents in the instant cases satisfy each and every condition which the contractors in *Parsons* failed to satisfy, with the sole exception of the terminability factor.

By holding in *Paragon, supra,* that the absence of a right to terminate on short notice on the part of the lessee did not confer an economic interest on the contractors, in the absence of the other factors listed in *Parsons,* this Court indicated by clear implication that the factor of terminability (on the part of either party) on short notice was irrelevant to the determination of whether a particular party possessed an economic interest.

Unlike in *Paragon* and *Parsons,* it is the lessees, and not contractors, who are claiming depletion in the instant cases.

Petitioner's reliance on *Helvering v. Bankline Oil Co.,* 303 U.S. 362 (1938), is misplaced. There the taxpayer had contracts with producers of natural gas, allowing the taxpayer to extract the gasoline from the gas owned by the producers and pay the producers 33-1/3% of the total gross proceeds derived from the sale of such gasoline, or at the option of the producers to deliver to the latter 33-1/3% of the salable gasoline so extracted. The Court disallowed the depletion allowance to the tax-

payer, holding that it had obtained, through its contracts, "an economic advantage from the production of gas," but "had no interest in the gas in place . . . had no capital investment in the mineral deposit which suffered depletion. . . ." (*id.*, at 368). There is no mention whatsoever in the opinion of the element of terminability, or even of the time period for which the contracts were made. Furthermore – unlike the instant cases – the taxpayer "had no interest as lessor or lessee, or as sub-lessor or sub-lessee, in any of the producing wells" (*id.*, at 366).

The "economic interest" language of Treasury Regulations Section 1.611-1(b) was adopted almost literally from the language of the opinion in the *Bankline* case, and has remained virtually unchanged since the regulations on this subject were first issued under the Internal Revenue Code of 1939 (Treas. Reg. 103, Section 19.23 (m)-1). These regulations have never contained any provision, or even a suggestion, of a requirement of non-terminability in order for a lessor or a lessee to be entitled to his equitably apportioned share of the depletion allowance, in accordance with Section 611(b)(1) of the Internal Revenue Code of 1954, *supra*, p. 3 and its predecessor statutory provisions.

Even before the Congress provided for equitable apportionment of the depletion allowance between lessor and lessee (Section 214(a)(10), Revenue Act of 1918, c. 18, 40 Stat. 1058, 1068, which is the predecessor of Section 611(b)(1), 1954 Code), this Court recognized that a lessee had an investment in minerals in place, and held (under the Revenue Act of 1916, c. 463, 39 Stat. 756, 757-8, 765, 767, Sections 2, 10 and 12(a)), that both the lessor and the lessee, where there was a mineral lease in effect, were entitled to a deduction for depletion "according to the value of the interest of each in the

property" (*Lynch v. Alworth-Stephens Company*), 267 U.S. 364, 369 (1925).[11]

Section 1.611-1(c)(2) of Treasury Regulations, entitled "Special Rules - Leases," *supra*, p. 5 (which presumably represents the Commissioner's official interpretation of Section 611(b)(1) of the 1954 Code) contains no provision or suggestion that the depletion deduction to which a lessor, a lessee, or any other possessor of an economic interest is entitled, is in any way dependent upon terminability or non-terminability of his interest on short notice. It is significant that, since the *Bakertown* case, *supra*, p. 12, was decided in 1973, the Treasury has made no move to modify either this regulatory provision or Treasury Regulations Section 1.611-1(b) ("Economic interest"), *supra*, p. 4, and App. C, Petition for a Writ of Certiorari, pp. 24a-25a, so as to exclude from the depletion deduction terminable leases like those involved in the instant cases.

Citing *Commissioner v. Southwest Exploration Co.*, *supra*, p. 15, Petitioner asserts that:

> If the market price of the minerals rises above the lessor's royalty, the lessor will assuredly exercise his right to terminate the lease on short notice and will either enter into a more profitable lease or extract the mineral himself and sell it. [Petition for a Writ of Certiorari, page 15.]

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[11] The now obsolete G.C.M. 26290, 1950-1 Cum. Bull. 42 (See Rev. Rul. 70-277, 1970-1 Cum. Bull. 280), cited and relied upon by Petitioner (Petition for a Writ of Certiorari, page 12), cited *Alworth-Stephens* with approval, and neither explicitly stated nor implied that lessees were required to have leases which were not terminable by their lessors for at least a year, in order to qualify for depletion deductions.

There is a total absence in the record of any basis for this assertion. On the contrary, as far as Black Hawk Coal Corporation is concerned, the lessee mined coal continuously from the time the lease was executed in 1964, through the taxable years in question (1970, 1972, and 1972), and until the minable coal was exhausted in 1976, without having its lease terminated by the lessor (Stipulation of Facts, ¶¶ 2, 3, 4, 5, and 7). This was true even though coal prices rose dramatically, especially during the oil crises of 1973 and 1974. Similarly, in neither the Swank case nor the Bull Run case was any lease ever terminated by action of the lessor.

The lessee receives percentage depletion only if it sells the coal. Mining without sale is not sufficient, since depletion is based on the gross income from the property, exclusive of rents or royalties paid by the lessee (Section 613(a), Internal Revenue Code of 1954). Contrary to Petitioner's assertion, the "economic reality" is that Respondents did mine and sell the coal on which they claimed depletion; the "legal abstraction" is the lessors' unexercised right of termination.

Additionally, the relevant decisions of this Court, noted above, clearly indicate that a lessee otherwise entitled to an allowance for percentage depletion remains entitled thereto with respect to coal extracted under the lease, unless and until the lessor exercises his right of termination.

IV.

RESPONDENTS ARE ENTITLED TO PERCENTAGE DEPLETION AS THE ONLY POSSIBLE APPLICANTS FOR IT.

If Respondents are not entitled to the allowance for percentage depletion, there will be no depletion allowed on the coal mined under these leases. In the case of Black Hawk, where the actual mining of the coal was done by independent contractors employed by Black Hawk (the lessee) for this purpose, no claim for percentage depletion has been made by either Black Hawk's lessor or its contractors (Stipulation of Facts, ¶ 9). In the case of Bull Run, the lessor did not claim depletion (Lindsley Deposition, page 9). The lessor did take capital gains on royalties under Section 631(c), Internal Revenue Code of 1954 (*id.*, 16). In the case of Swank, the lessor was a county government, and therefore had no reason to claim depletion. (Statement of the Case, *supra,* p. 6.)

The denial of percentage depletion to Respondents where, as in these cases, there are no other possible claimants, would bring about an untenable and inequitable result, clearly contrary to the intention of the Congress in enacting the "equitable apportionment" provision, Section 611(b)(1), Internal Revenue Code of 1954, *supra,* p. 3.

The deduction for percentage depletion is mandatory in all cases where it exceeds cost depletion, and it must be computed on the basis of an arbitrary percentage (in the case of coal, 10%) of the "gross income from the property" (Section 613, Internal Revenue Code of 1954). In 1951, the Congress provided capital gains treatment for the recipients of coal royalties, in lieu of percentage depletion (Revenue Act of 1951, Section 325,

P.L. 183, 65 Stat. 452, 501-2, the predecessor of Section 631(c) of the Internal Revenue Code of 1954).

Ever since that time, only lessees of coal lands and others similarly situated – *i.e.*, those who have acquired an "economic interest" through arrangements other than leases – are entitled to any amount of percentage depletion. Both Section 631(c) of the 1954 Code (Appendix A, p. 2a) and §1.611-1(b)(2) of the Treasury Regulations, *supra*, p. 4, clearly specify that coal lessors and sublessors not actively engaged in the mining or preparation of coal are entitled to capital gains treatment instead of percentage depletion.

It is not within the province of the Commissioner, contrary to the statutory provisions above cited, to completely eliminate depletion on a portion of the gross income from the coal property – that is, on the difference between the selling price of the coal and the royalty paid by the lessee to the lessor – as he has attempted to do in these cases. Neither is it appropriate for the Commissioner to reallocate such portion of the depletion allowance from the lessee to the lessor, as Petitioner appears to suggest (Petition for a Writ of Certiorari, page 17).

In *Paragon Jewel Coal Company, Inc. v. Commissioner, supra,* pp. 14-16, this Court thoroughly considered the provisions of Section 631(c), Internal Revenue Code of 1954, and clearly indicated that "an owner who by contract disposes of the coal in place while retaining an economic interest is relegated to capital gains treatment of the royalties received," unless he is actively engaged in the mining of coal, in which case he is entitled to percentage depletion (380 U.S., at 636-7). By no possible interpretation of the statutory provisions could any of the lessors in the instant cases be considered to be within the "exemptive language in Section 631(c)," referred to by

the Court in *Paragon* (*ibid.*), so as to be entitled to any portion of the percentage depletion allowance on the coal mined from the leases.

CONCLUSION

The Petition for a Writ of Certiorari should be denied.

Respectfully submitted,

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APPENDIX

APPENDIX A

(1) Internal Revenue Code of 1954 (26 U.S.C.)

Section 613(c). Percentage Depletion. Definition of Gross Income From Property.

(c) Definition of Gross Income From Property. – For purposes of this section –

(1) Gross Income From The Property. – The term "gross income from the property" means, in the case of a property other than an oil or gas well and other than a geothermal deposit, the gross income from mining.

(2) Mining. – The term "mining" includes not merely the extraction of the ores or minerals from the ground but also the treatment processes considered as mining described in paragraph (4) (and the treatment processes necessary or incidental thereto), and so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which such treatment processes are applied thereto as is not in excess of 50 miles unless the Secretary finds that the physical and other requirements are such that the ore or mineral must be transported a greater distance to such plants or mills.

(3) Extraction of the Ores or Minerals From the Ground. – The term "extraction of the ores or minerals from the ground" includes the extraction by mine owners or operators of ores or minerals from the waste or residue of prior mining. The preceding sentence shall not apply to any such extraction of the mineral or ore by a purchaser of such waste or residue or of the rights to extract ores or minerals therefrom.

(4) Treatment Processes Considered as Mining. – The following treatment processes where applied by

the mine owner or operator shall be considered as mining to the extent they are applied to the ore or mineral in respect of which he is entitled to a deduction for depletion under section 611:

(A) In the case of coal – cleaning, breaking, sizing, dust allaying, treating to prevent freezing, and loading for shipment;

* * * * *

Section 631(c). Disposal of Coal or Domestic Iron Ore With a Retained Economic Interest.

(C) Disposal of Coal or Domestic Iron Ore With a Retained Economic Interest. – In the case of the disposal of coal (including lignite), or iron ore mined in the United States, held for more than 1 year before such disposal, by the owner thereof under any form of contract by virtue of which such owner retains an economic interest in such coal or iron ore, the difference between the amount realized from the disposal of such coal or iron ore and the adjusted depletion basis thereof plus the deductions disallowed for the taxable year under section 272 shall be considered as though it were a gain or loss, as the case may be, on the sale of such coal or iron ore. Such owner shall not be entitled to the allowance for percentage depletion provided in section 613 with respect to such coal or iron ore. This subsection shall not apply to income realized by any owner as a co-adventurer, partner, or principal in the mining of such coal or iron ore, and the word "owner" means any person who owns an economic interest in coal or iron ore in place, including a sublessor. The date of disposal of such coal or iron ore shall be deemed to be the date such coal or iron ore is mined. In determining the gross income, the adjusted gross income, or the taxable income of the lessee, the deductions

allowable with respect to rents and royalties shall be determined without regard to the provisions of this subsection. This subsection shall have no application, for purposes of applying subchapter G, relating to corporations used to avoid income tax on shareholders (including the determinations of the amount of the deductions under section 535(b)(6) or section 545(b)(5)). This subsection shall not apply to any disposal of iron ore –

(1) to a person whose relationship to the person disposing of such iron ore would result in the disallowance of losses under section 267 or 707(b), or

(2) to a person owned or controlled directly or indirectly by the same interests which own or control the person disposing of such iron ore.

(2) Treasury Regulations on Income Tax (26 C.F.R.)

Section 1.272-1. Expenditures relating to disposal of coal or domestic iron ore.

(a) *Introduction.* Section 272 provides special treatment for certain expenditures paid or incurred by a taxpayer in connection with a contract (hereafter sometimes referred to as a "coal royalty contract" or "iron ore royalty contract") for the disposal of coal or iron ore the gain or loss from which is treated under section 631(c) as a section 1231 gain or loss on the sale of coal or iron ore. See paragraph (e) of §1.631-3 for special rules relating to iron ore. The expenditures covered by section 272 are those which are attributable to the making and administering of such a contract or to the preservation of the economic interest retained under the contract. For examples of such expenditures, see paragraph (d) of this section. For a taxable year in which gross royalty income is realized under the contract of disposal, such expendi-

tures shall not be allowed as a deduction. Instead, they are to be added to the adjusted depletion basis of the coal or iron ore disposed of in the taxable year in computing gain or loss under section 631(c). However, where no gross royalty income is realized under the contract of disposal in a particular taxable year, such expenditure shall be treated without regard to section 272.

(b) *In general.* (1) Where the disposal of coal or iron ore is covered by section 631(c), the provisions of section 272 and this section shall be applicable for a taxable year in which there is income under the contract of disposal. (For purposes of section 272 and this section, the term "income" means gross amounts received or accrued which are royalties or bonuses in connection with a contract to which section 631(c) applies.) All expenditures paid or incurred by the taxpayer during the taxable year which are attributable to the making and administering of the contract disposing of the coal or iron ore and all expenditures paid or incurred during the taxable year in order to preserve the owner's economic interest retained under the contract shall be disallowed as deductions in computing taxable income for the taxable year. The sum of such expenditures and the adjusted depletion basis of the coal or iron ore disposed of in the taxable year shall be used in determining the amount of gain or loss with respect to the disposal. See § 1.631-3. For special rule in case of loss, see paragraph (c) of this section. Section 272 and this section do not apply to capital expenditures, and such expenditures are not taken into account in computing gain or loss under section 631(c) except to the extent they are properly part of the depletable basis of the coal or iron ore.

(2) The expenditures covered under section 272 and this section are disallowed as a deduction only with respect to a taxable year in which income is realized under

the coal royalty contract (or iron ore royalty contract) to which such expenditures are attributable. Where no income is realized under the contract in a taxable year, these expenditures shall be deducted as expenses for the production of income, or as a business expense, or they may be treated under section 266 (relating to taxes and carrying charges) if applicable.

(3) The provisions of section 272 and this section apply to a taxable year in which income from the disposal by the owner of coal or iron ore held by him for more than 6 months is subject to the provisions of section 631(c) even though the actual mining of coal or iron ore under the coal royalty contract (or iron ore royalty contract) does not take place during the taxable year. Where the right under the contract to mine coal or iron ore for which advance payment has been made expires, terminates, or is abandoned before the coal or iron ore is mined, and paragraph (c) of § 1.631-3 requires the owner to recompute his tax with respect to such payment, the recomputation must be made without applying the provisions of section 272 and this section.

(c) *Losses.* If, in any taxable year, the expenditures referred to in section 272 and this section plus the adjusted depletion basis (as defined in paragraph (b)(2) of § 1.631.3) of the coal or iron ore disposed of during the taxable year exceed the amount realized under the contract which is subject to section 631(c) during the taxable year, such excess shall be considered under section 1231 as a loss from the sale of property used in the trade or business and, to the extent not availed of as a reduction of gain under that section, shall be a loss deductible under section 165(a) (relating to the deduction of losses generally).

(d) *Examples of expenditures.* (1) The expenditures referred to in section 272 include, but are not limited to, the following items, if such items are attributable to the making or administering of the contract or preserving the economic interest therein: Ad valorem taxes imposed by State or local authorities, costs of fire protection, costs of insurance (other than liability insurance), costs incurred in administering the contract (including costs of bookkeeping and technical supervision), interest on loans, expenses of flood control, legal and technical expenses, and expenses of measuring and checking quantities of coal or iron ore disposed of under the contract. Whether the interest on loans is attributable to the making or administering of the contract or preserving the economic interest therein will depend upon the use to which the borrowed monies are put.

(2) Any expenditure referred to in this section which is applicable to more than one coal royalty contract or iron ore royalty contract shall be reasonably apportioned to each of such contracts. Furthermore, if an expenditure applies only in part to the making or administering of the contract or the preservation of the economic interest, then only such part shall be treated under section 272. The apportionment of the expenditure shall be made on a reasonable basis. For example, where a taxpayer has other income (such as income from oil or gas royalties, rentals, right of way fees, interest, or dividends) as well as income under section 631(c), and where the salaries of some of its employees or other expenses relate to both classes of income, such expenses shall be allocated reasonably between the income subject to section 631(c) and the other income. Where a taxpayer has more than one coal royalty contract or iron ore royalty contract, expenditures under this section relating to a contract from which no income has been received in the taxable year

may not be allocated to income from another contract from which income has been received in the taxable year.

Section 1.612-1. Basis for allowance of cost depletion.

(a) *In general.* The basis upon which the deduction for cost depletion under section 611 is to be allowed in respect of any mineral or timber property is the adjusted basis provided in section 1011 for the purpose of determining gain upon the sale or other disposition of such property except as provided in paragraph (b) of this section. The adjusted basis of such property is the cost or other basis determined under section 1012, relating to the basis of property, adjusted as provided in section 1016, relating to adjustments to basis, and the regulations under such sections. In the case of the sale of a part of such property, the unrecovered basis thereof shall be allocated to the part sold and the part retained.

(b) *Special rules.* (1) The basis for cost depletion of mineral or timber property does not include:

(i) Amounts recoverable through depreciation deductions, through deferred expenses, and through deductions other than depletion, and

(ii) The residual value of land and improvements at the end of operations.

In the case of any mineral property the basis for cost depletion does not include amounts representing the cost or value of land for purposes other than mineral production. Furthermore, in the case of certain mineral properties, such basis does not include exploration or development expenditures which are treated under section 615(b) or 616(b) as deferred expenses to be taken into account as deductions on a ratable basis as the units of minerals benefited thereby are produced and sold. However, there shall be included in the basis for cost depletion of oil and gas property the amounts of capitalized

drilling and development costs which, as provided in §1.612-4, are recoverable through depletion deductions. In the case of timber property, the basis for cost depletion does not include amounts representing the cost or value of land.

(2) Where a taxpayer elects to treat the cutting of timber as a sale or exchange of such timber, the basis for cost depletion shall be the fair market value of such timber as of the first day of the taxable year in which such timber is cut and such value shall be considered for such taxable year and all subsequent taxable years as the cost of such timber for all purposes for which such cost is a necessary factor. See section 631(a).

(c) *Cross references.* In cases where the valuation, revaluation, or mineral content of deposits is a factor, see paragraphs (c), (d), (e), and (f) of §1.611-2. In cases where the valuation, revaluation, or quantity of timber is a factor, see paragraphs (e), (f), and (g) of §1.611.3. For definitions of the terms "property", "fair market value", "mineral enterprise", "mineral deposit", and "minerals", see paragraph (d) of §1.611-1. For rules with respect to treatment of depletion accounts on taxpayer's books, see paragraph (b) of §1.611-2 in the case of mineral property, and paragraph (c) of §1.611-3 in the case of timber property.

Section 1.613-1. Percentage depletion; general rule.

In the case of a taxpayer computing the deductions for depletion under section 611 with respect to minerals on the basis of a percentage of gross income from the property, as defined in section 613(c), § 1.613-3, and § 1.613-4, such deduction shall be the percentage of such gross income as specified in section 613(b) and § 1.613-2. The deduction shall not exceed 50 percent

of the taxpayer's taxable income from the property (computed without allowance for depletion). Such taxable income shall be computed in accordance with § 1.613-5. In no case shall the deduction for depletion computed under this section be less than the deduction computed upon the cost or other basis of the property provided in section 612 and the regulations thereunder. The apportionment of the deduction between the several owners of economic interests in a mineral deposit will be made as provided in paragraph (c) of § 1.611-1. For rules with respect to "gross income from the property" and for definition of the term "mining," see §§ 1.613-3 and 1.613-4. For definitions of the terms "property," "mineral deposit," and "minerals," see paragraph (d) of § 1.611-1.

Section 1.631-3. Gain or loss upon the disposal of coal or domestic iron ore with a retained economic interest.

(a) *In general.* (1) The provisions of section 631(c) apply to an owner who disposes of coal (including lignite), or iron ore mined in the United States, held for more than 6 months before such disposal under any form or type of contract whereby he retains an economic interest in such coal or iron ore. The difference between the amount realized from disposal of the coal or iron ore in any taxable year, and the adjusted depletion basis thereof plus the deductions disallowed for the taxable year under section 272, shall be gain or loss upon the sale of the coal or iron ore. See paragraph (b)(4) of this section for the definition of "owner." See paragraph (3) of this section for special rules relating to iron ore.

(2) In the case of such a disposal, the provisions of section 1231 apply, and the coal or iron ore shall be considered to be property used in the trade or business

for the taxable year in which it is considered to have been sold, along with other property of the taxpayer used in the trade or business as defined in section 1231(b), regardless of whether the coal or iron ore is property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business. Whether gain or loss resulting from the disposition of the coal or iron ore which is considered to have been sold will be deemed to be gain or loss resulting from a sale of a capital asset held for more than 6 months will depend on the application of section 1231 to the taxpayer for the taxable year; *i.e.*, if the gains do not exceed the losses, they shall not be considered as gains and losses from sales or exchanges of capital assets but shall be treated as ordinary gains and losses.

(b) *Rules for application of section.* (1) For purposes of section 631(c) and this section, the date of disposal of the coal or iron ore shall be deemed to be the date the coal or iron ore is mined. If the coal or iron ore has been held for more than 6 months on the date it is mined, it is immaterial that it had not been held for more than 6 months on the date of the contract. There shall be no allowance for percentage depletion provided in section 613 with respect to amounts which are considered to be realized from the sale of coal or iron ore under section 631(c).

(2) The term "adjusted depletion basis" as used in section 631(c) and this section means the basis for allowance of cost depletion provided in section 612 and the regulations thereunder. Such "adjusted depletion basis" shall include exploration or development expenditures treated as deferred expenses under section 615(b) or 616(b), or corresponding provisions of prior income tax laws, and be reduced by adjustments under section

1016(a)(9) and (10), or corresponding provisions of prior income tax laws, relating to deductions of deferred expenses for exploration or development expenditures in the taxable year or any prior taxable years. The depletion unit of the coal or iron ore disposed of shall be determined under the rules provided in the regulations under section 611, relating to cost depletion.

(3)(i) In determining the gross income, the adjusted gross income, or the taxable income of the lessee, the deductions allowable with respect to rents and royalties (except rents and royalties paid by a lessee with respect to coal or iron ore disposed of by the lessee as an "owner" under section 631(c)) shall be determined without regard to the provisions of section 631(c). Thus, the amounts of rents and royalties paid or incurred by a lessee with respect to coal or iron ore shall be excluded from the lessee's gross income from the property for the purpose of determining his percentage depletion without regard to the treatment of such rents or royalties in the hands of the recipient under this section. See section 613 and the regulations thereunder.

(ii) (*a*) However, a lessee who is also a sublessor may dispose of coal or iron ore as an "owner" under section 631(c). Rents and royalties paid with respect to coal or iron ore disposed of by such a lessee under section 631(c) shall increase the adjusted depletion basis of the coal or iron ore and are not otherwise deductible.

(*b*) The provisions of this subdivision may be illustrated by the following example:

Example. B is a sublessor of a coal lease; A is the lessor; and C is the sublessee. B pays A a royalty of 50 cents per ton. C pays B a royalty of 60 cents per ton. The amount realized by B under section 631(c) is 60 cents per ton and will be reduced by the adjusted deple-

tion basis of 50 cents per ton, leaving a gain of 10 cents per ton taxable under section 631(c).

(4)(i) The provisions of this section apply only to an owner who has disposed of coal or iron ore and retained an economic interest. For the purposes of section 631(c) and this section, the word "owner" means any person who owns an economic interest in coal or iron ore in place, including a sublessor thereof. A person who merely acquires an economic interest and has not disposed of coal or iron ore under a contract retaining an economic interest does not qualify under section 631(c). A successor to the interest of a person who has disposed of coal or iron ore under a contract by virtue of which he retained an economic interest in such coal or iron ore is also entitled to the benefits of this section. Section 631(c) and this section shall not apply with respect to any income realized by any owner as co-adventurer, partner, or principal in the mining of such coal or iron ore.

(ii) The provisions of this subparagraph may be illustrated by the following examples:

Example (1). A owns a tract of coal land in fee. A leases to B the right to mine all the coal in this tract in return for a royalty of 30 cents per ton. B subleases his right to mine coal in this tract to C, who agrees to pay A 30 cents per ton and to pay to B an additional royalty of 10 cents per ton. Section 631(c) applies to the royalties of both A and B, if the other requisites of the section have been met.

Example (2). Assume the same facts as in example (1), except that A dies leaving his royalty interest to D. D has an economic interest in the coal in place and qualifies for section 631(c) treatment with respect to his share of the royalties since he is a successor in title to A.

Example (3). Assume the same facts as in example (1), except that E agrees to pay a sum of money to C in return for 10 cents per ton on the coal mined by C. E has an economic interest, since he must look solely to the extraction of the coal for the return of his investment. However, E has not made a disposal of coal under a contract wherein he retains an economic interest, and, therefore, does not qualify under section 631(c). E is entitled to depletion on his royalties.

(c) *Payments received in advance of mining.* (1)(i) Where the conditions of paragraph (a) of this section are met, amounts received or accrued prior to mining shall be treated under section 631(c) as received from the sale of coal or iron ore if the contract of disposal provides that such amounts are to be applied as payment for coal or iron ore subsequently mined. For example, advance royalty payments or minimum royalty payments received by an owner of coal or iron ore qualify under section 631(c) where the contract of disposal grants the lessee the right to apply such royalties in payment of coal or iron ore mined at a later time.

(ii) The provisions of this subparagraph may be illustrated by the following example:

Example. A acquires coal rights on January 1. On January 30, A enters into a contract of disposal providing that mining shall begin July 2, and mining actually begins no earlier. Any advance payments which A receives qualify under section 631(c).

(2) However, if the right to mine coal or iron ore under the contract expires, terminates, or is abandoned before the coal or iron ore which had been paid for is mined, the taxpayer shall treat payments attributable to the unmined coal or iron ore as ordinary income and not as received from the sale of coal or iron ore under section 631(c). Accordingly, the taxpayer shall recompute his

tax liability for the taxable year in which such payments were received. The recomputation shall be made in the form of an amended return where necessary.

(3) Bonuses received or accrued by an owner in connection with the grant of a contract of disposal shall be treated under section 631(c) as received from the sale of coal or iron ore to the extent attributable to coal or iron ore held for more than 6 months. The rules contained in paragraph (d) of § 1.631-2 relating to bonuses in the case of contracts for the disposal of timber shall be equally applicable in the case of bonuses received for the grant of a contract of disposal of coal or iron ore under this section.

APPENDIX B

Cases from Fourth, Fifth, Sixth, Ninth, and Tenth Circuits on "Economic Interest"

United States v. Stallard, 273 F.2d 847 (4th Cir. 1959), and *McCall v. Commissioner,* 312 F.2d 699 (4th Cir. 1963), are distinguishable on their facts from the present cases and thus provide little support for Petitioner's position. In *Stallard* the court denied depletion deductions to members of a partnership engaged in the strip mining of coal under a contract with the owners of coal-bearing land. The agreement provided that the partnership should furnish the mining equipment and should mine and deliver the coal to the landowners at a fixed price per ton. The latter had the right to cancel the contract at any time upon the giving of thirty (30)-days' written notice. It is clear from the opinion that the court did not rely solely on short-term terminability in denying depletion deductions to the contractors, though it accorded considerable weight to that factor. In *McCall* the court also held that coal contractors whose contract could be terminated without cause upon thirty (30)-days' written notice by the lessee who hired them were not entitled to percentage depletion; but there, too, the claimants possessed no legal interest in the coal in place and were required under their contract to deliver all coal mined to the lessee at a fixed price per ton.

United States v. Wade, 381 F.2d 345 (5th Cir. 1967), involved a contract miner who was entitled to be paid by the owner of dolomite in place a fixed amount per ton for quarrying the mineral and delivering it to the owner. In denying depletion to the contract miner, the court expressly stated that the contract was not a mineral lease or a grant of minerals, and that nothing in its

terms indicated any intention to convey a right or interest in dolomite in place (*id.*, at 350, n.7), and clearly regarded the factor of terminability for cause on thirty (30)-days' notice as being of only incidental importance. Furthermore, the owner of the dolomite in place had claimed, and had been held by the District Court to be entitled to, the entire depletion allowance under the same mining contract with Wade (*id.*, at 351).

In *Winters Coal Co., Inc. v. Commissioner,* 496 F.2d 995 (5th Cir. 1974) [*reversing* 57 T.C. 249 (1971)], the court allowed depletion to a lessee under a one-year coal stripping lease, which was terminable by either party on thirty (30)-days' notice, where the lessee was required to and did acquire surface rights. The writer of the opinion, citing *Bakertown* (*supra,* p. 12) with approval, determined that short-notice terminability did not disqualify an otherwise depletable leasehold interest (*id.*, at 997-8, 1000). The other two judges on the panel did not reach that issue, but held that the lease was depletable because of the lessee's surface rights (*ibid.*).

Ramey v. Commissioner, 398 F.2d 478 (6th Cir. 1968), involved a situation where the owner of the coal-bearing land was also the sole purchaser of the coal. The Court of Appeals for the Sixth Circuit approved the findings of the Tax Court to the effect that the landowner did not intend to surrender any capital interest in the coal to the taxpayer and that an alleged royalty paid under an agreement with the landowner was no more than an offset or reduction in the price paid for the coal, and accordingly denied depletion.

In *Usibelli v. Commissioner,* 229 F.2d 539 (9th Cir. 1955), the unsuccessful claimant of percentage depletion mined coal for the U.S. Army under contract, the coal belonged to the Army, payment prices depended on min-

ing costs, rather than on the market price of the coal, and the taxpayer could mine only limited amounts as permitted by the Government.

In *Rissler & McMurry Co., Inc. v. United States,* 480 F.2d 684 (10th Cir. 1973), the court denied a depletion allowance to a construction company which built and paved roads for a city, under a contract whose bid specification contained a provision that the successful bidder could use a gravel pit owned by the city as a source of construction material upon payment of two cents per ton or three cents per cubic yard, and where the city and taxpayer later made an oral agreement under which minor amounts of the material were sold by the taxpayer to other parties upon approval by the city council and payment of a royalty. The case is clearly distinguishable from the cases at bar, in that the contract reflected no intention by the city to surrender its interest in the gravel and the taxpayer did not look solely to the extraction of the gravel for a return of its investment.